1

Personal Filing Status

Your family and personal status directly affects the tax you pay as follows. It determines the:

- Threshold amount for filing a tax return.
- Tax rates applied to your taxable income; *see* ¶1.1.
- Dependency exemptions that you may claim; *see* Chapter 22.
- Right to claim the dependent care credit and the earned income credit; *see* Chapter 25.

TAX RATE SCHEDULES

1996 Tax Rate Schedules: Use ONLY if your taxable income is $100,000 or more. If less, use the Tax Tables in the Tax Organizer

Schedule X—Use if your filing status is Single

If taxable income is:

Over—	*But not over—*	*The tax is—*	*Of the amount over—*
$ 0	$24,000	15%	$ 0
24,000	58,150	$3,600.00+ 28%	24,000
58,150	121,300	13,162.00 + 31%	58,150
121,300	263,750	32,738.50 + 36%	121,300
263,750		84,020.50 + 39.6%	263,750

Schedule Z—Use if your filing status is Head of household

If taxable income is:

Over—	*But not over—*	*The tax is—*	*Of the amount over—*
$ 0	$32,150	15%	$ 0
32,150	83,050	$4,822.50 + 28%	32,150
83,050	134,500	19,074.50 + 31%	83,050
134,500	263,750	35,024.00 + 36%	134,500
263,750		81,554.00+ 39.6%	263,750

Schedule Y-1—Use if your filing status is Married filing jointly or Qualifying widow(er)

If taxable income is:

Over—	*But not over—*	*The tax is—*	*Of the amount over—*
$ 0	$40,100	15%	$ 0
40,100	96,900	$6,015.00 + 28%	40,100
96,900	147,700	21,919.00+ 31%	96,900
147,700	263,750	37,667.00+ 36%	147,700
263,750		79,445.00+ 39.6%	263,750

Schedule Y-2—Use if your filing status is Married filing separately

If taxable income is:

Over—	*But not over—*	*The tax is—*	*Of the amount over—*
$ 0	$20,050	15%	$ 0
20,050	48,450	$3,007.50+ 28%	20,050
48,450	73,850	10,959.50 + 31%	48,450
73,850	131,875	18,833.50+ 36%	73,850
131,875		39,722.50 + 39.6%	131,875

Personal Filing Status

¶1.1 Tax Rates Based on Personal Status

Your tax rate depends on your personal or family status as of the last day of 1996. There are five filing statuses: single, married filing jointly, married filing separately, head of household, and qualifying widow(er).

As shown on page 8, the most favorable brackets apply to married persons filing jointly and qualifying widows(ers). Qualifying widow(er) status generally applies to persons widowed in 1995 or 1994 who have a dependent child; *see* ¶1.6. The least favorable brackets are those for married persons filing separately, but filing separately may still be advisable in certain situations, as discussed in the chart on page 10 and in ¶1.2.

If an unmarried person maintains a home for a child or other relative, he or she may qualify to use the rate schedule for head of household (¶1.10), which is more advantageous than using the single person rate schedule. In certain cases, a married person who is living apart from his or her spouse can also use the head of household rate schedule instead of the less favorable tax brackets for married persons filing separately; *see* page 10 and also ¶1.10.

Marital status determined at end of year. If by the last day of the year you are divorced under a final decree or you are legally separated under a decree of divorce or separate maintenance, you are not treated as married. However, if at the end of the year you are living apart from your spouse or separated under an "interlocutory" or temporary divorce decree, you are still considered married.

If, at the end of the year, you live together in a *common law marriage* recognized by the law of the state in which you live or the state where the marriage began, you are treated as married.

Tax computations. How to compute your tax using the tax tables or tax rate schedules is discussed in Chapter 23.

LAW ALERT

Marriage Penalty Relief?

Married persons are subject to a "marriage penalty" when the tax they must pay on a joint return exceeds the combined tax they would pay if they were single and filing individual returns. The marriage penalty generally applies where each spouse earns approximately the same income. On the other hand, if one spouse has little or no income, there generally is a marriage bonus or "singles penalty" in that the spouse with most of the income pays a lower tax as a married person filing jointly than if he or she were single.

Congress has considered various proposals in recent years to provide at least partial relief for the marriage penalty, but none had been enacted as of the time this book went to press; any developments will be reported in the Supplement.

¶1.2 When Filing Separately May Be Advantageous for Spouses

Filing a joint return will save taxes where you or your spouse earns all, or substantially all, of the taxable income. Where both of you earn taxable income, you should figure your tax on joint and separate returns to determine which method provides the lower tax.

Separate returns may save taxes where filing separately allows you to claim more deductions. On separate returns, larger amounts of medical expenses, casualty losses or miscellaneous deductions may be deductible because lower adjusted gross income floors apply. Unless one spouse earns substantially more than the other, separate and joint tax rates are likely to be the same, regardless of the type of returns filed. The Example on page 11 illustrates how filing separately can save you taxes.

Suspicious of your spouse? If you suspect that your spouse may be evading taxes and may not meet tax liabilities due on a joint return, you may want to file a separate return. By filing separately, you avoid liability for unpaid taxes due on a joint return, plus interest and penalties. Although the innocent spouse rules may protect a spouse filing a joint return, this protection will not apply if you have knowledge of your spouse's financial and tax situation; *see* ¶1.3 and ¶1.4.

Standard deduction restriction on separate returns. Keep in mind that if you and your spouse file separately, *both* must either itemize or claim the standard deduction, which is $3,350 in 1996 for married persons filing separately (¶13.3). Thus, if one spouse itemizes, the other spouse must also itemize even if he or she would get a larger deduction from the $3,350 standard deduction.

Joint return required for certain benefits. Also be aware that certain tax benefits may be claimed by married persons only if they file jointly.

If you want to take advantage of the $25,000 rental loss allowance (¶10.2) or the credit for the elderly (Chapter 34), you must file jointly unless you live apart for the whole year. You must file jointly to claim an IRA deduction for a nonworking spouse (¶8.3). A joint return is also required to claim the dependent care credit or the earned income credit (Chapter 25), unless you live apart for the last six months of the year. Furthermore, if you receive Social Security benefits, one-half of your benefits are generally subject to tax on a separate return, because on a separate return you are not allowed a base amount exemption; *see* Chapter 34.

Switching from Separate to Joint Return

If you and your spouse file separate returns, you have three years from the due date (without extensions) to change to a joint return. If a joint return is filed and the due date has passed, you may not elect to file separate returns. The choice of filing a joint return is irrevocable once the due date is passed. The filing of a separate or joint estimated tax does not commit you to a similar tax return.

FILING STATUS IF MARRIED AT THE END OF 1996

Filing Jointly

Married couples may pay less tax by filing jointly. Filing jointly allows the use of joint return rates.

You may file a joint return if you are legally married on the last day of 1996.

You need not live together provided you are legally married. A couple legally separated under a final decree of divorce or separate maintenance as of the end of 1996 may *not* file a joint return.

You may file jointly if your spouse died during 1996; *see* ¶1.5.

If one spouse is a nonresident alien, you may file jointly *only* if you make a special election to be taxed on your worldwide income; *see* ¶1.8.

You *must* file jointly to make an IRA deduction on behalf of a nonworking spouse (¶8.3). To claim the credit for the elderly (Chapter 34), you must file jointly unless you lived apart for the entire year. You must file jointly to claim the dependent care credit or the earned income credit (Chapter 25), unless you live apart and qualify as a head of household as explained in this chart.

On a joint return, each spouse is liable for the entire tax. If one spouse does not pay, the other spouse may be liable even though all of the income was earned by the spouse who failed to pay the tax. An "innocent" spouse who files a joint return may be relieved of fraud penalties and tax liability in certain circumstances; *see* ¶1.4.

For community property rules; *see* ¶1.9.

Filing Separately

Filing separately may be advisable where both spouses earn taxable income and have separate deductions, as explained at ¶1.3. You may not file a joint return and must use tax rates for married persons filing separately in these cases:

1. Your spouse files a separate return. If you are experiencing marital discord, you may be forced to file separately unless your spouse consents to a joint return.
2. You or your spouse is claimed by someone else as a dependent; *see* ¶22.13.
3. You and your spouse have different tax reporting years. If you report on the calendar year but your spouse reports on a fiscal year, you must file separately unless you get permission from the IRS to change your reporting year (Form 1128). This bar to joint filing does not apply when your tax year begins on the same day, but ends because of the death of either or both spouses. A spouse who has never filed a tax return may elect to use the other spouse's tax year as his or her first tax year; then they can file a joint return. That a husband and wife had different tax years before their marriage is no bar to a joint return.
4. You or your spouse is a nonresident alien and you do not make an election to be taxed on your worldwide income; *see* ¶1.8.

Living Apart from Spouse: Filing as Unmarried Head of Household

If you lived apart from your spouse during the last half of 1996, and your child lived with you for most of the year, you may qualify for tax purposes as "unmarried" and use head of household rates, which are lower than rates for married persons filing separately.

The following four tests must be met for you to file separately from your spouse as a head of household:

1. Your spouse was not a member of your household during the last six months of 1996.
2. You maintain your home as a household which was the principal place of abode for your child, adopted child, or stepchild for more than half of 1996. However, a foster child must be a member of your household for the entire year.
3. You are entitled to claim the child as a dependent. Ignore this test if the noncustodial spouse claims the exemption for the child under the rules of ¶22.11.
4. You provide over half of the cost of supporting the household.

FILING STATUS IF NOT MARRIED AT THE END OF 1996

Single Person

If you are not married at the end of 1996, use the rate for single individuals, unless you qualify as a surviving spouse or a head of household.

If you are widowed, you are "unmarried" and use rates for single individuals regardless of the number of years you were married. There is an exception for recent widows or widowers supporting children, as explained in the "qualifying widow(er)" column.

Head of Household

If at the end of the year you are not married, you may use special head-of-household rates if you meet these tests:

1. You are not married at the end of the year.
2. You maintain a household for more than half of 1996 for your child or a dependent relative. The household must be your home and the main residence of your dependent relative except that a dependent parent need not live with you. However, you must maintain a dependent parent's separate household for the entire year to claim head of household status based on that support.
3. You pay more than one-half the cost of the household.
4. You are a U.S. citizen or resident alien during the entire tax year.

These rules are explained in detail in ¶1.10. If you qualify as a head of household, you may claim a larger standard deduction if you do not itemize deductions than if you file as a single person; *see* ¶13.1.

Qualifying Widow(er)

If you are a widow or widower and your spouse died in 1994 or 1995, you may use 1996 joint return tax rates if you meet these four tests:

1. You maintain your home as the main home of your child for the entire year and you furnish over half the cost of maintaining the household.
2. You are entitled to claim the child as a dependent; *see* ¶22.1.
3. In the year your spouse died, you could have filed a joint return.
4. You did not remarry before January 1, 1997.

If you meet these tests, your filing status is qualifying widow or widower; *see* ¶1.6.

EXAMPLE

Your 1996 adjusted gross income (AGI) is $65,000 and your spouse's is $50,000. You have medical expenses of $7,000; your spouse's are $1,000. You have an $8,000 casualty loss. Your miscellaneous expenses are $2,600; your spouse's are $500. You have deductible mortgage interest expenses of $5,000; your spouse's are $2,000. Your deductible state and local taxes are $2,000; your spouse's are $1,000. Neither of you claims exemptions for dependents.

As the example worksheet below shows, filing separate returns saves an overall $1,097, because you can deduct more on separate returns. Furthermore, if you filed jointly you would have received no deduction for medical expenses and casualty losses because they would have been eliminated by the higher adjusted gross income floors. The 3% reduction of itemized deductions (¶13.8) applies to you but not your spouse when you file separately. The phaseout of personal exemptions (¶22.15) does not apply regardless of how you file. Finally, when you file separately, the 31% bracket applies to you, but your spouse is in the 28% bracket. On a joint return, your top bracket is 31%.

Item	*You (Separately)*	*Your spouse (Separately)*	*Joint*
AGI	**$65,000**	**$50,000**	**$115,000**
Medical expenses	7,000	1,000	8,000
Less 7½ % of AGI	4,875	3,750	8,625
*Allowable medical	2,125	0	0
*Taxes	2,000	1,000	3,000
*Mortgage interest	5,000	2,000	7,000
Casualty loss	8,000	0	8,000
Less 10% of AGI	6,500		11,500
*Allowable casualty	1,500		0
Miscellaneous expenses	2,600	500	3,100
Less 2% of AGI	1,300	1,000	2,300
*Allowable miscellaneous	1,300	0	800
***Total itemized**	11,925	3,000	10,800
Less 3% reduction	181	0	0
Net itemized	**11,744**	**3,000**	**10,800**
Personal exemptions	2,550	2,550	5,100
Net itemized plus exemptions	**14,294**	**5,550**	**15,900**
Taxable income	50,706	44,450	99,100
Tax liability	**11,665**	**9,847**	**22,609**
Total tax filing separately			21,512
Savings from filing separately			***1,097***

Alternative Minimum Tax (AMT). If you are subject to AMT, filing separately may allow a full AMT exemption on one of the separate returns if your spouse's income does not come within the phaseout range for the exemption; *see* ¶23.3.

Can Filing Separately Avoid Exemption Phaseout or Itemized Deduction Reduction?

Filing separately will sometimes allow either you or your spouse to avoid part of the personal exemption phaseout (¶22.15) or the 3% reduction to specified itemized deductions (¶13.8). If you file jointly and have total 1996 adjusted gross income (AGI) exceeding $176,950, the exemption phaseout applies. If you file separately, the phaseout does not apply to the spouse reporting separate AGI of $88,475 or less. On the other hand, where your joint AGI is $176,950 or less, a spouse reporting AGI over $88,475 on a separate return will be subject to the phaseout although no phaseout would apply on a joint return.

If for 1996 you itemize deductions, the deductions for taxes, mortgage interest, charitable donations, and miscellaneous deductions are reduced by 3% of AGI exceeding $117,950 on a joint return, or exceeding $58,975 on a separate return. If you file separately, the reduction does not apply on a separate return showing AGI of $58,975 or less. Where joint AGI is $117,950 or less, a spouse filing separately with separate AGI over $58,975 is subject to the 3% reduction although no reduction would apply on a joint return.

Filing a Joint Return

¶1.3 Signing the Joint Return

Both you and your spouse must sign the joint return. Under the following rules, if your spouse is unable to sign, you may sign for him or her.

If, because of illness, your spouse is physically unable to sign the joint return, you may, with the oral consent of your spouse, sign his or her name on the return followed by the words "By ______, Husband (or Wife)." You then sign the return again in your own right and attach a signed and dated statement with the following information: (1) the return being filed, (2) the tax year, (3) the reason for the inability of the sick spouse to sign, and (4) that the sick spouse has consented to your signing.

To sign for your spouse in other situations, you need authorization in the form of a power of attorney, which must be attached to the return. IRS Form 2848 may be used.

If your spouse does not file, you may be able to prove you filed a joint return even if your spouse did *not* sign and you did not sign as your spouse's agent where:

- You intended it to be a joint return—your spouse's income was included (or the spouse had no income).
- Your spouse agreed to have you handle tax matters and you filed a joint return.
- Your answers to the questions on the tax return indicate you intended to file a joint return.
- Your spouse's failure to sign can be explained.

EXAMPLE

The Hills generally filed joint returns. In one year, Mr. Hill claimed joint return filing status and reported his wife's income as well as his own; in place of her signature on the return, he indicated that she was out of town caring for her sick mother. She did not file a separate return. The IRS refused to treat the return as joint. The Tax Court disagreed. Since Mrs. Hill testified that she would have signed had she been available, her failure to do so does not bar joint return status. The couple intended to make a joint return at the time of filing.

CAUTION

Both Spouses Jointly Liable

When you sign a joint return, you and your spouse may be held individually liable for the entire tax due, plus interest and any penalties. You may be held liable for the entire tax even if your spouse earned all the income.

If you divorce, you remain jointly liable for the tax due on joint returns filed before the divorce. You remain liable even if your divorce agreement provides that your ex-spouse is responsible for taxes on the prior joint returns; the IRS is not bound by your agreement.

In one case, the Tax Court held that a settlement between the IRS and a bankrupt husband did not extend to the wife. The wife was not involved in the bankruptcy proceeding and the IRS could get a separate assessment against her for the balance of the joint return deficiency.

In limited cases, an innocent spouse may avoid liability, as discussed in ¶1.4.

Proposals have been made to change the joint liability standard to one of proportionate liability based on each spouse's share of the joint return income and deductions; developments if any will be reported in the Supplement.

¶1.4 Innocent Spouse Rules

To a limited extent, a spouse who files a joint return may be relieved of tax liability based on omitted income or invalid tax deductions or credits. These three conditions must be met:

1. There is a tax understatement exceeding $500 due to the omission of gross income attributable to the other spouse. In determining gross income, community property rules (¶1.9) are disregarded, except that rental income or other income derived from property is treated as owned equally by the spouses.

   Condition (1) may also be met if there is a tax understatement exceeding $500 due to deductions or credits claimed by the other spouse that have no basis in law or fact, and the tax liability exceeds a specific percentage of the innocent spouse's adjusted gross income for the taxable year preceding the year in which the IRS mails a deficiency notice. If the innocent spouse's adjusted gross income in the year preceding the mailing of a deficiency notice was $20,000 or less, the tax understatement attributable to the other spouse's improper deductions must exceed 10% of the preceding year's adjusted gross income. If adjusted gross income in the preceding year was more than $20,000, the tax understatement for which relief is sought must exceed 25% of the preceding year's adjusted gross income. If the innocent spouse has remarried as of the end of the preceding year, the new spouse's income must be included to determine the innocent spouse's adjusted gross income for purposes of applying the 10% and 25% tests.
2. In signing the joint return, the innocent spouse did not know of and had no reason to know of the omission of income or erroneous deductions or credits; *see* below.
3. Taking into account all the circumstances, it would be inequitable to hold the innocent spouse liable for the tax. The IRS will consider the extent to which the "innocent" spouse benefited from the tax underpayment beyond normal support in deciding the "equity" issue.

How much "knowledge" will defeat an "innocent spouse" claim? Where relief from tax liability is based on the other spouse's omission of income, mere knowledge of the underlying transaction that produced the omitted income (such as a tax-sheltered investment) has been held to be enough to defeat innocent spouse status. According to the Tax Court, knowledge of the underlying transaction can also defeat innocent spouse relief based on the other spouse's claim of deductions or credits with no basis in law or fact. However, in improper deduction cases, several appeals courts have

held that knowledge of the underlying transaction will not block relief for a spouse who shows that at the time the joint return was signed, he or she could not be reasonably expected to know that the improper deduction would substantially lower the tax due. In applying this test, the innocent spouse's level of education and involvement in the couple's financial affairs should be taken into account.

¶1.5 Death of Spouse During the Year

You do not lose the right to file a joint return when your spouse dies during the year. In general, a joint return is filed by you and the executor or administrator. But you alone may file a joint return if you are otherwise entitled to file jointly and:

1. The deceased has not filed a separate return, and
2. No executor or administrator has been appointed before the due date for filing the return.

If you do file jointly, you include on the return all of your income and deductions for the full year and your deceased spouse's income and deductions *up to the date of death* (*see* ¶1.12).

As a surviving spouse, you may *not* file a joint return for you and your deceased spouse if:

1. You remarry before the end of the year of your spouse's death. In this case you may file jointly with your new spouse. A final return for the deceased spouse must be filed by the executor or administrator using the filing status of married filing separately.
2. You or your deceased spouse has a short year because of a change in annual accounting period.
3. Either spouse was a nonresident alien at any time during the tax year; but *see* ¶1.8.
4. The executor or administrator revokes the return. When the executor or administrator is later appointed, he or she may revoke the joint return by filing a separate return for the decedent. Even if you have properly filed a joint return for you and the deceased spouse (as just discussed), the executor or administrator is given the right to revoke the joint return. But a state court held that a co-executrix could not refuse to sign a joint return where it would save the estate money. To revoke the joint return, the executor must file a separate return within one year of the due date (including extensions). The executor's separate return is treated as a late return; interest charges and a late filing penalty apply. The joint return filed by the surviving spouse is deemed to be his or her separate return. Tax on that return is recalculated by excluding items belonging to the deceased spouse.

Signing the return. A joint return reporting a decedent's income should list the names of the surviving spouse and the deceased. Where there is an executor or administrator, the return is signed by the surviving spouse and the executor or administrator in his or her official capacity. If the surviving spouse is the executor or administrator, he or she signs once as surviving spouse and again as the executor or administrator. Where there is no executor or administrator, the surviving spouse signs, followed by the words, "taxpayer and surviving spouse."

Surviving spouse's liability. If a joint return is filed and the estate cannot pay its share of the joint income tax liability, the surviving spouse may be liable for the full amount. Once the return is filed and the filing date passes, the survivor can no longer change the joint return election and file a separate return unless an administrator or executor is appointed after the due date of the return. In that case, as previously discussed, the executor may disaffirm the joint return.

If a surviving spouse who will be appointed executor or administrator is concerned about estate insolvency, it may be advisable to hedge as follows: (1) File separate returns. If it is later seen that a joint return is preferable, the surviving spouse has three years to change to a joint return. (2) File jointly but postpone being appointed executor or administrator until after the due date of the joint return. In this way, the joint return may be disaffirmed if the estate cannot cover its share of the taxes.

¶1.6 Death of Spouse in 1994 or 1995

If your spouse died in either 1994 or 1995 and you meet the following three requirements, your 1996 filing status is *qualifying widow or widower*, which allows you to use joint return rates.

1. You did not remarry before 1997 (if you did remarry you may file a joint return with your new spouse).
2. You may claim as your dependent in 1996 a child, stepchild, adopted child, or foster child who lived with you during 1996 (except for temporary absences) and you paid over half the cost of maintaining your home.
3. You were able to file jointly in the year of your spouse's death, even if you did not actually do so.

If you meet all these tests, use the 1996 tax table or rate schedule for qualifying widows or widowers; *see* page 8.

Spouse's death before 1994. If your spouse died before 1994 and you did not remarry before 1997, you may be able to use head of household rates for 1996 if you qualify under the rules of ¶1.10.

¶1.7 Divorce or Separation Decree

A final decree of divorce or separate maintenance entered into before the end of 1996 prevents you from filing a joint return. Unless you qualify as head of household (¶1.10), you must use the rates for single individuals. You may not claim an exemption for a divorced or legally separated spouse, even if you contribute all of his or her support, but *see* ¶22.2 if the divorce or separation is not final.

If you are married but live apart from your spouse and care for a child, you may be able to qualify as a head of household; *see* ¶1.10.

If, before a final decree of divorce has been made, you are separated under an "interlocutory" decree or temporary order, you are still considered married and may file a joint return. Once the decree

is made final, the privilege to file jointly ends. Alimony paid during the period covered by the interlocutory decree is deducted by one spouse and reported by the other spouse as income if separate returns are filed.

If a divorce decree is interlocutory but another state waives the waiting period and permits a spouse to remarry, the IRS will recognize the new marriage and allow the filing of joint returns by the newly married couple. But a court has refused to allow a joint return where a new marriage took place in Mexico during the interlocutory period in violation of California law.

Invalidated Prior Divorce

The IRS and Tax Court do not allow a joint return with a new spouse if a prior divorce decree has been declared invalid by a state court. The federal appeals court for the Second Circuit allows the joint return; the Ninth Circuit does not.

¶1.8 Nonresident Alien Spouse

If either you or your spouse was a nonresident alien (¶1.14) during *any part* of the year, a joint return may be filed only if both of you make a special election to be taxed on your worldwide income. Thus, if you are a U.S. citizen and your spouse is a nonresident alien at the beginning of the year who becomes a resident (¶1.14) during the year, the special election to file jointly must be made.

If the election is not made, you may be able to claim your nonresident alien spouse as an exemption on a return filed as married filing separately, but only if the spouse had no income and could not be claimed as a dependent by another taxpayer; *see* ¶22.2. If the alien spouse becomes a resident before the beginning of the next tax year, you may file jointly for that year.

If one spouse is a nonresident alien and the couple does not make the election to file jointly, certain community property rules do not apply; *see* ¶1.9.

Election to file a joint return. Where a U.S. citizen or resident is married to a nonresident alien, the couple may file a joint return if both elect to be taxed on their *worldwide income.* The requirement that one spouse be a U.S. citizen or resident need be met only at the close of the year. Joint returns may be filed in the year of the election and all later years until the election is terminated.

A couple that makes the election must keep books and records of their worldwide income and give the IRS access to such books and records. If either spouse does not provide the necessary information to the IRS, the election is terminated. Furthermore, the election is terminated if either spouse revokes it or dies; revocation before the due date of the return is effective for that return. The election automatically terminates for the year of death of either spouse. However, if the survivor is a U.S. citizen or resident, he or she may claim the benefits of being a qualifying widow(er); *see* ¶1.5. The election to file jointly also terminates if the couple is legally separated under a decree of divorce or separate maintenance. Termination is effective as of the beginning of the taxable year of the legal separation. If neither spouse is a citizen or resident for any part of the taxable year, an election may not be made and an existing election is revoked. Once the election is terminated, neither spouse may ever again make the election to file jointly.

Electing to file a joint return does not terminate the special withholding on the nonresident alien's income.

Nonresident Alien Becomes Resident

Where one spouse is a U.S. citizen or resident and the other is a nonresident alien who becomes a resident during the tax year, the couple may make a special election to file a joint return for that year and be taxed on their worldwide income. Thereafter, neither spouse may make the election again even if married to a new spouse. Tests for determining status as a resident or nonresident alien are at ¶1.16.

¶1.9 Community Property Rules

If you live in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, or Wisconsin, the income and property you and your spouse acquire during the marriage is generally regarded as community property. But note that there are some instances in which community property rules are disregarded for tax purposes; these instances are clearly highlighted in the pertinent sections of this book.

Community property means that each of you owns half of the community income and community property, even if legal title is held by only one spouse.

Separate property may still be owned. Property owned before marriage generally remains separate property; it does not become community property when you marry. Property received during the marriage by one spouse as a gift or an inheritance from a third party is generally separate property. In some states, if the nature of ownership cannot be fixed, the property is presumed to be community property.

In some states, income from separate property may be treated as community property income. In other states, income from separate property remains the separate property of the individual owner.

Divorce or separation. If you and your spouse divorce, your community property automatically becomes separate property. A separation agreement or a decree of legal separation or of separate maintenance may or may not end the marital community, depending on state law.

When community income rules do not apply to separated couples. If a husband and wife in a community property state file separate returns, each spouse must generally report one-half of the community income. However, a spouse may be able to avoid reporting income earned by his or her spouse if they live apart during the entire calendar year and do not file a joint return.

To qualify, one or both spouses must have earned income for the year and none of that earned income may be transferred, directly or indirectly, between the spouses during the year. One spouse's payment to the other spouse solely to support the couple's dependent children is not a disqualifying transfer. If the separated couple qualifies under these tests, community income is allocated as follows:

- Earned income (excluding business or partnership income) is taxed to the spouse who performed the personal services.
- Business income (other than partnership income) is treated as the income of the spouse carrying on the business.
- Partnership income is taxed to the spouse entitled to a distributive share of partnership profits.

Innocent spouse rules applied to community property. As discussed above, community property rules may not apply to earned income where spouses live apart for the entire year and file separate returns. In addition, a spouse who files a separate return may be relieved of tax liability on community income which is attributable to the other spouse if he or she does not know (or have reason to know) about the income and if it would be inequitable under the circumstances for him or her to be taxed on such income. This rule applies to all tax years not closed by the statute of limitations.

The IRS may disregard community property rules and tax income to a spouse who treats such income as if it were solely his or hers and who fails to notify the other spouse of the income before the due date of the return (including extensions).

Death of spouse. The death of a spouse dissolves the community property relationship, but income earned and accrued from community property before death is community income.

Moving from a community property to a common law (separate property) state. Most common law states (those which do not have community property laws) recognize that both spouses have an interest in property accumulated while residing in a community property state. If the property is not sold or reinvested, it may continue to be treated as community property. If you and your spouse sell community property after moving to a common law state and reinvest the proceeds, the reinvested proceeds are generally separate property, which may be held as joint tenants, or in another form of ownership recognized by common law states.

Moving from a common law to a community property state. Separate property brought into a community property state generally retains its character as separately owned property. However, property acquired by a couple *after* moving to a community property state is generally owned as community property. In at least one state (California), personal property which qualifies as community property is treated as such, even though it was acquired when the couple lived in a common law state.

Supporting a dependent with separate rather than community income. Filing a Form 2120 multiple support agreement is not necessary where either parent can prove that he or she has income which is considered separate income rather than community income; that parent may be able to satisfy the more-than-50% support test. In certain community property states, the law may provide that income of a husband and wife living apart is considered separate income rather than community income.

Claiming Dependents on Separate Returns

Married parents in community property states who plan to file separate returns should be aware that neither parent may be able to claim an exemption for a dependent child. Where all of the couple's income is considered community income, each parent on a separate return is treated as having provided exactly one-half of the child's support, regardless of who actually paid it. Since neither parent has provided more than one-half of the support, neither can claim the child as a dependent.

To avoid this result, parents whose sole income is community income and who want to file separately should consider signing a multiple support agreement, Form 2120, designating which parent may claim the exemption.

Filing as Head of Household

¶1.10 Qualifying as Head of Household

If you are unmarried at the end of 1996 and you maintain a household for a child, parent, or other relative under the four tests listed below, you can file as "head of household." Tax rates are lower for a head of household than for a person filing as single (page 8) and the standard deduction is higher (Chapter 13). If you are married but for the last half of 1996 you lived apart from your spouse, you may also be able to qualify for head of household rates that are more favorable than the rates for married persons filing separately; *see* Test 1.

You have to meet the following four tests to qualify as head of household:

Test 1. You are not married at the end of the year, or, if married, lived apart from your spouse for the last half of 1996.

Test 2. You maintain a household for your child, parent, or other dependent relative.

Test 3. The household you maintain must be the main home of the dependent relative. According to the IRS, it must also be your main home, except in the case of your parent.

Test 4. You are a U.S. citizen or resident alien during the entire tax year. If you are a nonresident alien (¶1.16) for any part of the year, you are not eligible to file as head of household.

MEETING THE HEAD OF HOUSEHOLD TESTS

Test 1. You are "unmarried" for head of household purposes if you are any one of the following:

- *Single.*
- *A widow or widower and your spouse died before 1996.* If a dependent child lives with you, *see* ¶1.6 to determine if you may use the even more advantageous filing status of qualifying widow(er). If your spouse died in 1996, you are treated as married and cannot qualify as a 1996 head of household, but a joint return may be filed; *see* ¶1.5.
- *Legally separated or divorced under a final court decree.* A custody and support order does not qualify as a legal separation. An interlocutory decree (not final), such as a support order *pendente lite* (while action is pending) or a temporary order, has no effect for tax purposes until the decree is made final.
- *Married but living apart from your spouse.* You are considered unmarried for 1996 if your spouse was not a member of your household during the last six months of 1996, you file separate returns, and you maintain a household for more than half the year for a dependent child, stepchild, or adopted child. A foster child qualifies if he or she is a member of your household for the whole year. You must be able to claim the child as a dependent unless your spouse (the noncustodial parent) has the right to the exemption under the rules of ¶22.11.
- *Your spouse was a nonresident alien during any part of 1996 and you do not elect to file a joint return reporting your joint worldwide income (¶1.8).*

Test 2. You must pay more than half of the costs of maintaining a household for your child, stepchild, adopted child, grandchild, foster child, parent, or these other qualifying relatives: brothers or sisters; sons- or daughters-in-law; fathers- or mothers-in-law; brothers- or sisters-in-law; grandparents, step-parents, step-brothers or sisters; half-brothers or sisters; and uncles, aunts, nieces, or nephews by blood.

A child or relative other than your parent must *live with you* in that same home, as discussed under Test 3. Your parent does not have to live with you, but you must pay more than half the costs of your parent's household, whether your parent lives alone, with someone else, or in a senior citizen residence.

You do not qualify as a head of household if you support an unrelated family unit, such as a girlfriend or boyfriend with children. This is true even if you are entitled to claim them as exemptions under ¶22.1.

Does the relative have to be your dependent? A parent or relative other than a child must qualify as a dependent on your return; *see* Chapter 22.

Your child, grandchild, stepchild or adopted child who is unmarried at the end of the year does *not* have to be your dependent; a foster child *does* have to be your dependent. If the child is married, he or she must qualify as a dependent for you to claim head of household status unless you are divorced or separated and you have waived the exemption for your married child, or the child's other parent may claim the exemption under a pre-1985 agreement; *see* ¶22.11. A person married on the last day of the year is considered married for the whole year.

If you are married and for the last half of the year you lived apart from your spouse, you must be able to claim your child, married or unmarried, as your dependent unless you waive the exemption or your spouse (the noncustodial parent) may claim the exemption under a pre-1985 agreement, as explained at ¶22.11.

If a child or other relative qualifies as your dependent on the basis of a multiple support agreement (¶22.10), you do not qualify as head of household.

A spouse who is a nonresident alien during any part of the year is not a dependent who can qualify you for head of household status, even though you maintain a home for him or her.

Costs of maintaining the household. You must pay for more than half of the property taxes, mortgage interest, rent, utility charges, upkeep and repairs, domestic help, property insurance, and food eaten in the household. Do not consider the rental value of the lodgings provided the dependent or clothing, education costs, medical expenses, vacation costs, life insurance premiums, transportation costs, and the value of your work around the house. However, these expenses may be considered in figuring your support contribution in determining whether you may claim the child or other relative as a dependent; *see* ¶22.7.

HOUSEHOLD COSTS FOR THE YEAR

1. Property taxes	$	________
2. Mortgage interest		________
3. Rent paid		________
4. Insurance		________
5. Utilities		________
6. Domestic help		________
7. Repairs and upkeep		________
8. Food eaten in the home		________
9. Total of Lines 1–8		________
10. 50% of Line 9	$	________

If you paid more than the amount on Line 10, you "maintain" the household for purposes of Test 2.

EXAMPLE

Your mother lived with your sister in your sister's apartment, which cost $5,000 to maintain. Of this amount, you contributed $3,000, your sister $2,000. Your mother has no income and did not contribute any funds to the household. You qualify as head of household: For 1996, you paid over half the cost of maintaining the home for your mother, who also qualifies as an exemption on your return. A child or dependent relative other than your parent would have to live with you (Test 3 below) to enable you to file as head of household.

Two-family house. A mother was allowed head of household status by the Tax Court in the following case. She and her unmarried daughter rented one floor of a multilevel home. A married daughter lived on a different floor with her family. Parts of the home were shared. According to the court, the mother was a head of household, based on support of her unmarried daughter. Although she did not pay more than half of the total household expenses, she paid more than half the expenses attributable to her and her unwed daughter.

Test 3. The home that you maintain (Test 2) for your child or dependent relative must be his or her principal residence for more than half of 1996, or for all of 1996 in the case of a dependent parent's separate household. According to the IRS, that same home must also be *your* principal residence for more than half the year, unless you are maintaining a separate household for your parent. Some courts have held that the taxpayer must live for a "substantial" period of time in the same house as the dependent. An appeals court disagreed in one case; it allowed a mother to claim head of household status where she maintained a home for a child in one state and had her principal residence in another state. In the following case, the Tax Court upheld the IRS position.

EXAMPLE

Doctors advised McDonald that her mentally ill son might become self-sufficient if he lived in a separate residence, but one nearby enough for her to provide supervision. She took the advice and kept up a separate home for her son that was about a mile from her own home. She frequently spent nights at his home and he at hers. The Tax Court agreed with the IRS that McDonald could not file as head of household since her principal residence was not the same as her son's.

Temporary absences disregarded. You and your child or dependent relative are treated as having the same household (Test 3) while either of you is temporarily absent due to illness, education, business, vacation, military service, or fulfilling a child custody agreement. The IRS requires that it be reasonable to expect your qualifying child or dependent to return to your household after such a temporary absence, and that you continue to maintain the household during the temporary absence. Under this rule, you would lose the right to file as head of household if your dependent moved into his or her own permanent residence before the end of the year.

You may claim head of household status when your dependent is confined to a hospital or a sanitarium and his or her absence is temporary and you continue to maintain a household in expectation of his or her return.

In the year a qualifying dependent is born or dies, meeting the residence test for the portion of the year the dependent is alive allows you to claim head of household status.

Child May Be Head of Household

You may qualify as a head of household for filing purposes although not head of the family. For example, a son who earns more than his father and contributes more than half of the cost of maintaining the family may qualify as a head of household. That the father, not the son, exercises family control does not matter. The important factor is a dollar test: whether the head of household for tax purposes contributed more than half the cost of maintaining the household that is his or her home and the principal home of the qualifying dependents.

Tax Returns for Children

¶1.11 Filing for Your Child

The income of your minor child is *not* included in your return unless you make a special election to report a child's investment income under the rules of ¶24.5. A minor is considered a taxpayer in his or her own right. If the child is required to file a return, but is unable to do so because of age or for any other reason, the parent or guardian is responsible for filing the return.

A 1996 tax return must be filed for a dependent child who had more than $650 of gross income, where any of it was from investments. If your child had only earned income (for personal services) and no investment income, a 1996 tax return must be filed if the earned income exceeded $4,000.

If the child is unable to sign the return, the parent or guardian should sign the child's name in the proper place, followed by the words, "by (signature), parent (or guardian) for minor child." A parent is liable for tax due on pay earned by the child for services, but not on investment income.

A child who is not required to file a return should still do so for a refund of taxes withheld, if any.

Social Security numbers. A parent or guardian must obtain a Social Security number for a child before filing the child's first income tax return. The child's Social Security number must also be

provided to banks, brokers, and other payers of interest and dividends to avoid penalties and backup withholding; *see* ¶26.12. To obtain a Social Security number, file Form SS-5 with your local Social Security office. If you have applied for a Social Security number but not yet received it by the filing due date, write "applied for" on the tax return in the space provided for the number.

Whether or not you are filing a return for a child, you must obtain and report on your return a Social Security number for a child born before December 1, 1996, whom you are claiming as a dependent. Otherwise, you may be subject to a $50 penalty; *see* ¶22.14.

Kiddie Tax for Children Under Age 14

Children who are under age 14 at the end of 1996 generally must use Form 8615 to figure their 1996 tax if they had more than $1,300 of investment income; *see* ¶24.4. On Form 8615, the investment earnings over $1,300 are taxed at the parent's top tax rate. However, in certain cases under the rules of ¶24.5, parents may elect to report their children's investment income on their own return.

Wages You Pay Your Children. You may deduct wages paid to your children in your business. Keep records showing that their activities are of a business rather than personal nature.

Withholding for children. Children with wages are generally subject to withholding and should file Form W-4 with their employer. An exemption from withholding may be claimed only in limited cases. For example, in 1996, a child with any investment income who expected to be claimed as another taxpayer's dependent could claim an exemption from withholding only if the expected amount of investment income plus wages was $650 or less (this amount may change annually). Furthermore, the child must certify on Form W-4 that he or she had no federal tax liability in the prior year and expects to have no liability in the current year for which the withholding exemption is sought.

Wages you pay to your own children under age 18 for working in your business are not subject to FICA taxes (Social Security and Medicare); *see* ¶26.10.

Filing for a Deceased or Incompetent Person

¶1.12 Return for Deceased

When a person dies, another taxpaying entity is created—the decedent's estate. Until the estate is fully distributed, it will generally earn income for which a return must be filed. For example, Carlos Perez had a savings account. He died on June 30. Income earned on the account through June 30 is reported on his final income tax return, Form 1040. Income earned on the account from July 1 is reported on Form 1041, the income tax return for the estate. Form 1041 must be filed if the estate has gross income of $600 or more.

What income tax returns must be filed? If the decedent died after the close of the taxable year, but before the income tax return was filed, the following must be filed:

1. Income tax return for prior year;
2. Final income tax return, covering earnings in period from beginning of taxable year to date of death; and
3. Estate income tax return, covering earnings in period after decedent's death.

If the decedent died after filing a return for the prior tax year, then only 2 and 3 are filed.

EXAMPLE

Steven Jones died on March 31, 1997, before he could file his 1996 tax return. The 1996 income tax return must be filed by April 15, 1997. A final income tax return to report earnings from January 1, 1997, through March 31, 1997, will have to be filed on April 15, 1998. Jones's estate will have to file an income tax return on Form 1041 to report earnings and other income that were not paid to Jones before April 1, 1997.

Who is responsible for filing? The executor, administrator, or other legal representative is responsible for filing all returns. For purposes of determining whether a final income tax return for the decedent is due, the annual gross income test at page 2 is considered in full. You do not prorate it to the part of the year decedent lived. A surviving spouse may assume responsibility for filing a joint return for the year of death if no executor or administrator has been appointed and other tests are met (¶1.5). However, if a legal representative has been appointed, he or she must give the surviving spouse consent to file a joint return for the year of the decedent's death. In one case, a state court held that a co-executrix could not refuse consent and was required to sign a joint return where it would save the estate money.

How do you report the decedent's income and deductions? You follow the method used by the decedent during his or her life to account for the income *up to the date of death.* The income does *not* have to be put on an annual basis. Each item is taxed in the same manner as it would have been taxed had the decedent lived for the entire year.

If the deceased owned U.S. Savings Bonds, *see* ¶4.29.

When one spouse dies in a community property state (¶1.9), how should the income from the community property be reported during the administration of the estate? The IRS says that half the income is the estate's and the other half belongs to the surviving spouse.

Medical expenses of the decedent. If the estate pays the decedent's medical expenses within one year of the date of death, the expenses can be deducted on the decedent's last return, subject to the regular 7.5% of adjusted gross income floor (¶17.4). However, the expenses are not deductible for income tax purposes if they are deducted for estate tax purposes. To deduct such medical expenses

on the decedent's last return, a statement must be filed affirming that no estate tax deduction has been taken and that the rights to the deduction have been waived.

Decedent's Final Return

Do not report on the decedent's final return income that is received after his or her death, or accrues after or because of death if the decedent used the accrual method. It is taxed to the estate or beneficiary receiving the income in the year of the receipt. On the decedent's final return, only deductible expenses paid up to and including the date of death may be claimed. If the decedent reported on the accrual basis, those deductions accruable up to and including the date of death are deductible. If a check for payment of a deductible item was delivered or mailed before the date of the decedent's death, a deduction is allowable on the decedent's last return, even though the check was not cashed or deposited until after the decedent's death. If the check was not honored by the bank, the item is not deductible.

Partnership income. The final return includes partnership income or loss only from a partnership year that ends within the decedent's tax year. Thus, if a partner dies in July 1996 and the partnership's taxable year ends December 31, 1996, no partnership income or loss is included on the partner's final 1996 return. It is reported by the partner's executor or other successor in interest on the estate's income tax return.

Exemptions allowed an a final return. These are generally the same exemptions the decedent would have had if he or she had not died. You do not reduce the exemptions because of the shorter taxable year. If the deceased had contributed more than one-half of a dependent's annual support, a dependency exemption is claimed on his or her final return.

Estimated taxes. No estimated tax need be paid by the executor after the death of an unmarried individual; the entire tax is paid when filing the final tax return. But where the deceased and a surviving spouse paid estimated tax jointly, the rule is different. The surviving spouse is still liable for the balance of the estimated tax unless an amended estimated tax voucher is filed. Further, if the surviving spouse plans to file a joint return (¶1.5) which includes the decedent's income, estimated tax payments may be required; *see* Chapter 27.

Where the estate has gross income, estimated tax installments are not required on Form 1041-ES for the first two years after the decedent's death.

Signing the return. An executor or administrator of the estate signs the return. If it is a joint return, *see* ¶1.5.

Promptly Closing the Estate

To expedite the closing of the decedent's estate, an executor or other personal representative of the decedent may file Form 4810 for a prompt assessment. Once filed, the IRS has 18 months to assess additional taxes. Without making the request, the IRS has three years from the due date of the return to make assessments. Form 4810 must be filed separately from the final return, but should be sent to the District Director for the IRS district in which the return is filed.

When a refund is due on a final return. The decedent's final return may also be used as a claim for a refund of an overpayment of withheld or estimated taxes. Form 1310 may be used to get the refund, but the form is not required if you are a surviving spouse filing a joint return for the year your spouse died. If you are an executor or administrator of the estate and you are filing Form 1040, 1040A, or 1040EZ for the decedent, you do not need Form 1310, but you must attach to the return a copy of the court certificate showing your appointment as personal representative.

¶1.13 Return for an Incompetent Person

A legal guardian of an incompetent person files Form 1040 for an incompetent whose gross income meets the filing tests on page 2. Where a spouse becomes incompetent, the IRS says the other spouse may file a return for the incompetent without a power of attorney, if no legal guardian has been appointed. For example, during the period an individual was in a mental hospital, and before he was adjudged legally incompetent, his wife continued to operate his business. She filed an income tax return for him and signed it for him although she had no power of attorney. The IRS accepted the return as properly filed. Until a legal guardian was appointed, she was charged with the care of her husband and his property.

The IRS had accepted a joint return filed by a wife in her capacity as legal guardian for her missing husband. However, the Tax Court has held that where one spouse is mentally incompetent, a joint return may not be filed because the incompetent spouse was unable to consent to a joint return; an appeals court agreed.

How Nonresident Aliens File

¶1.14 Resident or Nonresident?

A *resident* alien, like a United States citizen, is taxed on worldwide income from all sources. A *nonresident* alien is generally taxed only on income from U.S. sources. A nonresident alien's income that is *effectively connected* with a U.S. business or capital gains from the sale of U.S. real estate are subject to tax at regular U.S. rates. Other capital gains are not taxed unless a nonresident alien has a U.S. business or is in the U.S. for 183 days during the year. Generally, investment income of a nonresident alien from U.S. sources that is *not effectively connected* with a U.S. business is subject to a 30% tax rate (or lower rate if provided by treaty).

Nonresident aliens must file Form 1040NR. If you are a nonresident alien, get a copy of IRS Publication 519, U.S. Tax Guide for Aliens. It explains how nonresident aliens pay tax, if any, to the U.S.

An alien's mere presence in the U.S. does not make him or her a "resident." An alien is generally treated as a "resident" only if he or she is a lawful permanent resident who has a "green card" or meets a substantial presence test; *see* ¶1.16.

Dual status. In the year a person arrives in or departs from the U.S., both resident and nonresident status may apply.

EXAMPLE

On May 1, 1996, Leon Marchand arrived on a nonimmigrant visa and was present in the U.S. for the rest of the year. From January 1 to April 31, 1996, he is a nonresident; from May 1 to the end of the year, he is a resident, under the 183-day test (¶1.16). Despite "dual status," he does not file two returns. He files one return, reporting income on the basis of his status for each part of the year.

Certain restrictions apply to dual status taxpayers. For example, a joint return may not be filed, unless you and your spouse agree to be taxed as U.S. residents for the entire year.

For details on filing a return for a dual status year, *see* IRS Publication 519 and the instructions to Form 1040NR.

¶1.15 How a Resident Alien Is Taxed

A resident alien is taxed on worldwide income like a U.S. citizen. The exclusion for foreign earned income may be claimed if the foreign physical presence test is satisfied; *see* ¶36.5. A resident alien may generally claim a foreign tax credit; *see* ¶36.14. He or she is taxed on a pension from a foreign government. A resident alien working in the United States for a foreign government is not taxed on the wages if the foreign government allows a similar exemption to U.S. citizens.

¶1.16 Who Is a Resident Alien?

The following tests determine whether an alien is taxed as a U.S. resident. Intent to remain in the U.S. is not considered.

You are treated as a resident alien and taxed as a U.S. resident if you meet either of the following tests for 1996:

1. You have been issued a "green card," which grants you the status of lawful permanent resident. If you were outside the U.S. for part of 1996 and then became a lawful permanent resident, *see* the rules for dual tax status on the next page.
2. You meet a substantial presence test. Under this test, you are treated as a U.S. resident if you were in the U.S. for at least 31 days during the calendar year and have been in the U.S. for 183 days within the last three years (the current year and the two preceding calendar years). The 183-day test is complicated and there are several exceptions.

183-day test. To determine if you meet the 183-day test for 1996, the following cumulative times are totaled. Each day in the U.S. during 1996 is counted as a full day. Each day in 1995 counts as ⅓ of a day; each day in 1994 counts as ⅙ of a day. Note that you must be physically present in the U.S. for at least 31 days in the current year. If you are not, the 183-day test does not apply.

Other exceptions to the substantial presence test are: commuting from Canada or Mexico; keeping a tax home and close contacts or connections in a foreign country; having a diplomatic, teacher, trainee, or student status; being a professional athlete temporarily in the U.S. to compete in a charitable sports event; or being confined in the U.S. for certain medical reasons. These exceptions are explained in the following paragraphs.

Commute from Mexico or Canada. If you regularly commute to work in the U.S. from Mexico or Canada, commuting days do not count as days of physical presence for the 183-day test.

Tax home/closer connection exception. If you are in the United States for less than 183 days during 1996, show that you had a closer connection with a foreign country than with the U.S., and keep a tax home there for the year, you generally will not be subject to tax as a resident under the substantial presence test. Under this exception, it is possible to have a U.S. abode and a tax home in a foreign country. A tax home is usually where a person has his or her principal place of business; if there is no principal place of business, it is the place of regular abode. Proving a tax home alone is not sufficient; the closer connection relationship must also be shown.

To claim the closer connection exception, you must file Form 8840 explaining the basis of your claim.

The tax home/closer connection test does not apply to an alien who is present for 183 days or more during a year or who has applied for a "green card." A relative's application is not considered as the alien's application.

Exempt-person exception. Days of presence in the U.S. are not counted under the 183-day test if you are considered an exempt person such as a teacher, trainee, student, foreign government–related person, or professional athlete temporarily in the U.S. to compete in a charitable sports event.

To exclude days of presence as a teacher, trainee, student, or professional athlete, you must file Form 8843 with the IRS.

A foreign government–related person is any individual temporarily present in the U.S. who (1) has diplomatic status or a visa which the Secretary of the Treasury (after consultation with the Secretary of State) determined represents full-time diplomatic or consular status; or (2) is a full-time employee of an international organization; or (3) is a member of the immediate family of a diplomat or international organization employee.

A teacher or trainee is any individual other than a student who is temporarily present in the U.S. under a "J" or "Q" visa and who substantially complies with the requirements for being so present.

A student is any individual who is temporarily present in the U.S. under either an "F," "J," "M," or "Q" visa and who substantially complies with the requirements for being so present.

The exception generally does not apply to a teacher or trainee who has been exempt as a teacher, trainee, or student for any part of two of the six preceding calendar years. However, if during the period you are temporarily present in the U.S. under an "F," "J," "M," or "Q" visa and all of your compensation is received from outside the U.S., you may qualify for the exception if you were exempt as a teacher, trainee, or student for less than four years in the six preceding calendar years. The exception also does not apply to a student who has been exempt as a teacher, trainee, or student for more than five calendar years, unless you show that you do not intend to reside permanently in the U.S. and that you have substantially complied with the requirements of the student visa providing for temporary presence in the U.S.

Medical exception. If you plan to leave but cannot physically leave the U.S. because of a medical condition that arose in the U.S., you may be treated as a nonresident, even if present here for more than 183 days during the year. You must file Form 8843 to claim the medical exception.

Tax Treaty Exceptions. The lawful permanent residence test and the substantial physical presence test do not override tax treaty definitions of residence. Thus, you may be protected by a tax treaty from being treated as a U.S. resident even if you would be treated as a resident under either test.

Dual tax status in first year of residency. If you first became a lawful permanent resident of the U.S. (received a green card) during 1996 and were not a U.S. resident during 1995, your period of U.S. residency begins with the first day in 1996 that you are present in the U.S. with the status of lawful permanent resident. Before that date, you are a nonresident alien. This means that if you become a lawful permanent resident after January 1, 1996, you have a *dual status tax year.* On Form 1040, you attach a separate schedule showing the income for the part of the year you are a nonresident.

To figure tax for a dual status year, *see* IRS Publication 519 and the instructions to Form 1040NR.

You also may have a dual status year if you were not a U.S. resident in 1995, and in 1996 you are a U.S. resident under the 183-day presence test. Your period of U.S. residency starts on the first day in 1996 for which you were physically present; before that date you are treated as a nonresident alien. However, if you meet the 183-day presence test (but not the green card test) and also spent 10 days or less in the U.S. during a period in which you had a closer connection to a foreign country than to the U.S., you may disregard the 10-day period. The purpose of this exception is to allow a brief presence in the U.S. for business trips or house hunting before the U.S. residency period starts.

EXAMPLES

1. Manuel Riveras, who has never before been a U.S. resident, lives in Spain until May 15, 1996. He moves to the U.S. and remains in the U.S. through the end of the year, thereby satisfying the physical presence test. On May 15, he is a U.S. resident. However, for the period before May 15, he is taxed as a nonresident.
2. Same facts as in Example 1, but Riveras attends a meeting in the U.S. on February 2 through 8. On May 15, he moves to the U.S.; May 15, not February 2, is the starting date of the residency. During February, he had closer connection to Spain than to the U.S. Thus, his short stay in February is an exempt period.

If you were not a resident during 1995 but in 1996 you satisfy both the lawful resident (green card) test and the 183-day presence test, your residence begins on the earlier of the first day you are in the U.S. while a lawful permanent resident and the first day of physical presence.

First-year choice. If you *do not* meet either the green card test or the 183-day substantial presence test for the year of your arrival in the U.S. or for the immediately preceding year, but you do meet the substantial presence test for the year immediately following the year of your arrival, you may elect to be treated as a U.S. resident for part of the year of your arrival. To do this, you must (1) be present in the U.S. for at least 31 consecutive days in the year of your arrival; and (2) be present in the U.S. for at least 75% of the number of days beginning with the first day of the 31-consecutive-day period and ending with the last day of the year of arrival. For purposes of this 75% requirement, you may treat up to five days of absence from the U.S. as days of presence within the U.S.

Do not count as days of presence in the U.S. days for which you are an *exempt individual* as discussed earlier.

You make the first-year election to be treated as a U.S. resident by attaching a statement to Form 1040 for the year of your arrival. A first-year election, once made, may not be revoked without the consent of the Internal Revenue Service.

If you make the election, your residence starting date for the year of your arrival is the first day of the earliest 31-consecutive-day period of presence that you use to qualify for the choice. You are treated as a U.S. resident for the remainder of the year.

Last year of residence. You are no longer treated as a U.S. resident as of your *residency termination date*. If you do not have a green card but are a U.S. resident for the year under the 183-day presence test, and you leave the U.S. during that year, your residency termination date is the last day you are present in the U.S., provided that: (1) after leaving the U.S. you had a closer connection to a foreign country than to the U.S. and had your tax home in that foreign country for the rest of the year, and (2) you are not treated as a U.S. resident for any part of the next calendar year.

If during the year you give up your green card (lawful permanent resident status) and meet tests (1) and (2), your residency termination date is the first day that you are no longer a lawful permanent resident. If during the year you meet both the green card test and the 183-day presence test and meet tests (1) and (2), your residency termination date is the *later* of the last day of U.S. presence or the first day you are no longer a lawful permanent resident. If tests (1) and (2) are *not* met, the residency termination date is the last day of the calendar year. In the year of your residency termination date, the filing rules for dual status taxpayers at ¶1.14 apply.

Interrupted period of residence. If you qualified as a U.S. resident during at least three consecutive calendar years and cease to be a U.S. resident, but later return to become a U.S. resident within three calendar years after the end of the initial residency period, you are taxable during the intervening period of nonresidence in the same way as a former U.S. citizen who became expatriated to avoid tax. This treatment applies only if the amount of tax under this rule exceeds the tax that would otherwise apply to you as a nonresident alien. The tax under this special rule is the regular graduated income tax, alternative minimum tax, and tax on lump-sum distributions from an employees' trust, applied only to your gross income effectively connected with a U.S. trade or business and your U.S.-source noneffectively connected gross income. For this purpose, U.S.-source gross income includes gains from the sale or exchange of (1) property (other than stock or debt obligations) located in the U.S. and (2) stock issued by a U.S. domestic corporation or debt obligations of U.S. persons or of the U.S. government, a state or political subdivision thereof, or the District of Columbia.

This rule is designed to prevent a long-time U.S. resident from disposing of assets free of U.S. tax by leaving the U.S. for a short period and then resuming U.S. residence. The rule applies regardless of a resident's intention to avoid tax.

¶1.17 When an Alien Leaves the United States

You must obtain a "sailing permit," technically known as a "certificate of compliance," which states that you have fulfilled your income tax obligations to the U.S. Without it, unless you are excused from obtaining one, you will be required at your point of departure to file a tax return and pay any tax due.

You should apply for a sailing permit from your local District Director of Internal Revenue about two weeks, but no earlier than 30 days, before your departure. You submit all information pertaining to your income and stay in the U.S. such as passport and alien registration form, copies of U.S. tax returns for the past two years, bank records, and any profit and loss statements. You also file a Form 1040-C, on which you report income received and expected to be received through the date of departure. Form 2063 is a short form that may be used *only* in limited cases.

You may avoid paying tax if you satisfactorily convince the District Director that you are returning to the United States. In other cases, you may avoid paying tax on the current year (or previous year if the filing date has not yet passed) by posting a bond for the amount of tax due.

Sailing permit not required. Aliens in the following categories are not required to obtain a sailing permit—those traveling under a diplomatic passport, members of their households, and servants accompanying them; employees of foreign governments and international organizations, and members of their households whose official compensation is tax exempt and who receive no other income subject to U.S. tax.

In addition, a sailing permit is not required for students, industrial trainees, and exchange visitors, and any spouse and child of such persons admitted solely on an "F," "H-3," "H-4," or "J" visa, who have received no U.S. taxable income, except for the following amounts:

- Study or training allowances, including expenses for travel maintenance, and tuition;
- The value of any services or accommodations furnished for such study or training;
- Income from authorized employment; and
- Interest on certain portfolio obligations.

A sailing permit is also not required for an alien student, and any spouse and child of that alien, admitted solely on an "M" visa, who has received no U.S. gross income, except for income from authorized employment or interest earned on certain portfolio obligations.

Also exempt from this requirement are certain aliens temporarily in the U.S. who have received no U.S. taxable income, such as visitors on a "B-1" (if visit does not exceed 90 days) or "B-2" visa, a "C-1" visa, or similar arrangement; aliens admitted to the U.S. on a border-crossing identification card or for whom passports, visas, and border-crossing identification cards are not required; certain alien military trainees; and an alien resident of Canada or Mexico who frequently commutes between that country and the U. S. for employment purposes and whose wages are subject to withholding tax.

See IRS Publication 519 for further details.